No. 11251

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

CONSTANCE MAY GAVIN,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

BRIEF FOR THE UNITED STATES.

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Opinion Below.

The memorandum opinion of the court below is reported in 63 F. Supp. 425. [R. 29-31.]

Jurisdiction.

This appeal involves income taxes and interest thereon for 1934 in the aggregate amount of $27,371.54. [R. 2-11.] This amount was paid in four installments, on September 3, October 3, November 3 and December 2, 1938. [R. 4-5, 13, 28.] A claim for refund was filed on May 9, 1941 [R. 7-10], and rejected on January 6, 1943. [R. 11, 28.] On January 2, 1945, and within the time provided in Section 3772 of the Internal Revenue Code, the taxpayer brought an action in the District Court for the recovery of the taxes and interest paid. [R. 2-11.] The jurisdiction was conferred on the District Court by

Section 24, Twentieth, of the Judicial Code. Judgment for the taxpayer was entered on August 20, 1945 [R. 38-39], and an amended judgment for the taxpayer was entered on October 4, 1945, pursuant to stipulation. [R. 39-42.] Within three months thereafter, and on November 19, 1945, a notice of appeal was filed [R. 42], pursuant to the provisions of Section 128(a) of the Judicial Code, as amended.

Question Presented.

Whether the amount received by the taxpayer in compromise of her claim to be the illegitimate child and an heir to the estate of one Flood is exempted from taxable income as "property acquired by gift, bequest, devise, or inheritance" within the meaning of Section 22(b)(3) of the Revenue Act of 1934.

Statutes Involved.

The applicable statutes are set forth in the Appendix, *infra,* pp. 1-3.

Statement.

The facts established by stipulation between the parties, by the findings of fact of the court below and the admissions of the answer are these [R. 24-28, 32-36, 12-14]:

James L. Flood died testate in San Mateo County, California, on or about February 15, 1926. His last will was admitted to probate by the Superior Court of California for that county on March 11, 1926. [R. 33, 122-158.]

On March 13, 1927, the appellee (hereinafter called the "taxpayer") filed a petition for partial distribution in the court probating Flood's will, claiming that she was the illegitimate daughter, and, as such, was entitled to two-

ninths of his estate as a pretermitted heir. [R. 33-34.] A trial on the matters set forth in her petition was had before a jury and the trial court directed a verdict against the taxpayer and in favor of the estate in August, 1931. [R. 34.] An appeal was taken from the order directing a verdict against her. On April 18, 1933, the Supreme Court of California reversed the decision against the taxpayer and remanded the case for new trial, ruling that "there was competent evidence of sufficient substantiality, in support of the elements of legitimation, to necessitate the submission of the case to the jury." [R. 34, 78, 59-85.] *Estate of Flood,* 217 Cal. 763, 21 P. (2d) 579. Subsequent to that decision and before any further proceedings in the probate court, the taxpayer's claim was settled under written agreement, dated February 28, 1934, by which she received two-thirds of the amount of her claim. [R. 34.] The pertinent portions of the agreement are as follows [R. 86-94]:

> This Agreement made by Constance May Gavin, wife of John P. Gavin, the first party, with Maud Lee Flood, as Trustee under the Trusts created by paragraph "Third" of the Will of James L. Flood, deceased, on file and of record in the office of the Clerk of the Superior Court for San Mateo County, California, and Maud Lee Flood, individually, Mary Emma Flood Stebbins, wife of Theodore E. Stebbins, and James Flood, second parties,
>
> * * * * * * * *
>
> 4. Said James L. Flood left him surviving his widow, Maud Lee Flood, and two children and no others, namely, a son, James Flood, and a daughter, Mary Emma Flood (now Stebbins). Said James L. Flood left no descendants him surviving except his said son and his said daughter. Said James L. Flood

did not leave him surviving any other child by blood, adoption or otherwise, but left as his only heirs at law his said widow, Maud Lee Flood and his said two children above named, his daughter, Mary Emma Flood (now Stebbins) and his son, James Flood;

5. * * * There is no descendant of the said James L. Flood now living except the said Mary Emma Flood Stebbins, the said James Flood, and the said James Flood Stebbins;

* * * * * * * *

8. On March 15, 1927, the first party, Constance May Gavin, filed in the said Superior Court for San Mateo County an application and/or petition for partial distribution to her of a portion of said estate, claiming to be the illegitimate daughter of James L. Flood, and a pretermitted heir at law, and as such entitled to two-ninths of his estate. Said proceeding continued pending in the Superior Court for the County of San Mateo until the 7th day of August, 1931, on which day a judgment was entered that she was not the daughter of James L. Flood, whereupon an appeal was taken to the Supreme Court of California, which on the 18th day of April, 1933, reversed said Judgment and ordered the cause remanded to the Superior Court for San Mateo County for a new trial. A remittitur from said Supreme Court following said judgment was filed in the Superior Court of San Mateo County on the 20th day of May, 1933;

Since said last named day the said application and/or petition of the first party, Constance May Gavin, for partial distribution has continued and is now pending in the Superior Court for San Mateo County.

Said application and/or petition of the first party, Constance May Gavin, is at issue upon the issues raised by (a) her Second Amended Petition for Partial Distribution filed herein May 25, 1931; and (b) the Answer thereto filed herein May 25, 1931, by the following legatees and devisees under the will of said decedent, James L. Flood, and the following beneficiaries of legacies and devises in trust created in and by said will, to wit: * * *.

9. None of the parties of the second part, nor any of the beneficiaries of the trust created by Paragraph Third of the Will of said decedent, nor any of the legatees or devisees named in or taking under the will of said deceased, nor any of the respondents named above, recognizes or has ever recognized the validity of the claim thus put forward by the first party, and all of them have heretofore continuously denied and now deny that she is the daughter of the said James L. Flood, deceased.

10. Nevertheless the second parties do not desire to carry on the litigation and have arranged a compromise thereof with the first party whereunder the second parties will transfer, assign and set over to the said first party and her transferees and assigns certain interests to which the second parties are entitled under the will of said deceased as follows:

(a) The said Maud Lee Flood, as trustee of the trusts created by Paragraph Third of the will, is to set over and transfer to the said first party, and/or her assigns, 5896 shares of the capital stock of the Flood Realty Company, a corporation organized under the laws of the State of California.

(b) Said Maud Lee Flood, Mary Emma Flood Stebbins, and James Flood, are to set over and assign to said first party, and/or her assigns,

[after which there were listed certain securities, real property and cash]

In addition, the following legatees have abated a portion of the legacies given to them in the will (and interest), and as a result of said abatement $20,000. is to be paid to said first party which comes from:

[naming two religious institutions and five orphanages]

In addition to the foregoing, said Maud Lee Flood, Mary Emma Flood Stebbins, and James Flood are to pay to said first party and/or her assigns, the sum of $100,000. out of their own funds and not distributable out of the estate of said deceased, and are to make and agreement contemporaneously with the delivery by the first party of this agreement in respect of property belonging to the said estate not now known or discovered but which may later become known or discovered.

Now, Therefore, the first party, in consideration of the premises and of the payments and transfers aforesaid, does hereby

(1) Acknowledge receipt of the payments of the aforesaid sums of money and transfer to her, and/or her assigns, of the property above listed; and the writing dealing with property belonging to the estate not now known or discovered, which is mentioned above.

(2) Promise, covenant and agree with the said second parties, and each of them, their devisees, lega-

tees, successors in interest in estate and assigns, that she, the first party, Constance May Gavin, will never hereafter assert that she is the daughter of James L. Flood, nor claim any right, title or interest in or to his estate, or any part thereof, as an heir at law or child of said James L. Flood, nor ever assert any right, title or interest in any property derived by the second parties, or any of them, their successors, heirs, legatees or assigns, by, through or under the will of James L. Flood, deceased, except such property as she has received or may receive by transfer from the second parties as hereinabove stated, (or under the above mentioned agreement relating to property belonging to the said estate not now known or discovered) whether said property consists of the identical property derived by said second parties, or any of them, from the estate of said James L. Flood, deceased, or from rents, issues or profits thereof, or by the sale of any part of the same, and/or the reinvestment of the proceeds of such sale.

(3) Further covenant that she, the first party, Constance May Gavin, will not at any time assert or claim any relationship whatever to the second parties, or any of them, or make any claim against any person whomsoever, whether such person be one of the parties of the second part or the descendants of any of them, or otherwise related to them, (and whether such persons be now or later born) by reason of or based upon the claim or an assertion that she, the first party, Constance May Gavin, was the daughter of James L. Flood, or that she had any right of inheritance in the estates of any of the second parties, or of any other person or persons whomsoever now living or hereafter to be born upon the grown or predicated upon the assertion that she is or was the daughter of James L. Flood.

(4) Agree for herself and for her heirs, successors in interest, and assigns, to warrant and defend the title of the property of the second parties, their heirs, devisees, legatees, successors and assigns against all claim to said property or any thereof, or any part or parcel thereof, to be made by her, or by any person claiming under her, and the first party agrees on her own behalf and on behalf of her heirs, successors in interest, legatees and *and* devises, that neither she nor any of them, shall or will in any manner, or to any extent, set up or claim any right to participate or take part in the administration of the estate or estates of any person or persons whomsoever now or hereafter born based upon the claim or assertion that she is or was the daughter of James L. Flood.

In Witness Whereof, the first party has hereunto set her hand at the City and County of San Francisco, State of California, this 28th day of February, 1934.

CONSTANCE MAY GAVIN.

In accord with her agreement, taxpayer allowed her petition for partial distribution to come on for hearing without contest on February 28, 1934. The taxpayer consented to the use of the settlement agreement for the purpose of supporting the findings of fact, conclusions of law and judgment of the probate court. [R. 35.]

On February 28, 1934, the probate court entered the following, pertinent excerpts from which are quoted:

Minutes [R. 95-96]:

The trial and hearing on the petition for partial distribution of the estate of the above named deceased and hearing on the settlement of the second, third, fourth and final account and petition for final distribution of said estate came regularly on this day, * * *.

* * * and the evidence being closed, said matter was submitted to the court for consideration and decision, and now the court having considered the same and being fully advised herein,

It is ordered that the petition of Constance May Gavin for partial distribution of said estate be and the same is hereby denied.

* * * * * * * *

It is ordered that the second, third, and fourth and final accounts of executor be and the same are hereby settled and allowed as presented and final distribution of estate is hereby made as prayed for.

Decision: Findings of Fact and Conclusions of Law [R. 97, 98, 100-101]:

The above mentioned petition of Constance May Gavin for partial distribution (hereinafter for convenience sometimes called the petitioner) in the above entitled estate came on this day to be tried upon the issues raised by (a) her Second Amended Petition for Partial Distribution filed herein May 25, 1931; and (b) the Answer thereto filed herein May 25, 1931, by the following legatees and devisees under the will of the above named decedent named therein and the following beneficiaries of legacies and devises in trust created in and by said will, to-wit: * * *.

Evidence was offered and received in respect of and relevant to the issues created by said second amended petition and answer thereto, and thereupon the said second amended petition for partial distribution was submitted to the court for decision.

* * * * * * * *

FINDINGS OF FACT.

* * * * * * * *

James L. Flood was not and is not the father of said petitioner, Constance May Gavin; * * *

* * * * * * * *

The only living descendants of said James L. Flood are his daughter, the said Mary Emma Flood Stebbins, his son, the said James Flood, and his grandson, the said James Flood Stebbins, born of the marriage of Theodore Ellis Stebbins and Mary Emma Flood, as aforesaid.

CONCLUSIONS OF LAW.

* * * petitioner, Constance May Gavin is not the daughter, nor a child, nor an heir at law of the decedent, James L. Flood; (b) that petitioner did not succeed to any part or portion of his estate; (c) that the petitioner take nothing by her said Second Amended Petition nor her application for partial distribution; * * *.

Judgment [R. 103]:

It Is Hereby Ordered, Adjudged and Decreed as follows:

(1) Petitioner, Constance May Gavin, is not the daughter, nor a child, nor an heir at law of the decedent, James L. Flood;

(2) Petitioner, Constance May Gavin, did not succeed to any part or portion of the estate of James L. Flood, deceased.

(3) Petitioner, Constance May Gavin, take nothing by her Second Amended Petition nor by her application for partial distribution.

Decree of Final Distribution [R. 108, 113-114]:

Said application and/or petition of Constance May Gavin for partial distribution continued pending in this Court from the 20th day of May, 1933, to this date, when it was tried by the Court without a jury (a jury having been waived) and resulted in the "Decision: Findings of Fact and Conclusions of Law," and also in the "Judgment" which are on file herein and are final. In and by said judgment, among other things, it is ordered, adjudged and decreed as follows:

(a) Petitioner, Constance May Gavin, is not the daughter, nor a child, nor an heir at law of the decedent, James L. Flood;

(b) Petitioner, Constance May Gavin, did not succeed to any part or portion of the estate of James L. Flood, deceased;

(c) Petitioner, Constance May Gavin, take nothing by her second amended petition or by her application for partial distribution;

* * * * * * * *

(17) Said Maud Lee Flood, as such trustee [of the trust created in paragraph "Third" of Flood's will], consents to the distribution of 5896 shares of the capital stock of the Flood Realty Company which would otherwise be distributable to her as trustee, to the persons and in the number of shares below named,

and requests the court to make distribution accordingly:

To Constance May Gavin	2,948 shares Flood Realty Company
To Carmelita Aureguy	1,474 shares Flood Realty Company
To Maxwell McNutt	700 shares Flood Realty Company
To John J. Taa*fe*, and Tressie G. Taaffe, his wife, as Joint Tenants	700 shares Flood Realty Company
To Albert Mansfield	74 shares Flood Realty Company
	5,896

(18) Maud Lee Flood, individually, Mary Emma Flood Stebbins and James Flood, hereby consent to distribution out of property to which they would be otherwise entitled, and request the Court to make distribution as follows:

(a) To Constance May Gavin the following shares of stock in corporations organized and existing under the laws of the State of California:

[specifying certain securities]

(b) To Constance May Gavin the sum of $20,000.00 out of the legacies given by paragraph "Sec-

ond" of the Will and the abatement made by the legatees therein named;

(c) To Constance May Gavin an undivided 2/27ths interest in all of the lands situate in the Counties of Mendocino and Marin which are set forth and described in Schedules A and B attached to this decree;

(d) To John J. Taaffe an undivided 2/27ths interest in all of the lands situate in the Counties of Mendocino and Marin which are set forth and described in Schedules A and B attached to this decree;

In 1934 the taxpayer realized cash and securities, as a result of the above-mentioned settlement, of the value of $206,974.43. [R. 4, 13.] In her income tax return for that year she reported 40% of that amount, or $82,789.77, as capital gain and paid income tax thereon in the amount of $22,373.66, together with interest thereon. [R. 35-36, 159-160.] A claim for refund of this amount was filed on May 9, 1941, and rejected on January 6, 1943. [R. 36.]

The court below entered the conclusion of law "that none of the value of the property received by the plaintiff in the said compromise settlement of her said litigation for a share of said estate constituted taxable income to her", and entered judgment for the taxpayer in the amount of income taxes and interest thereon that she had paid for 1934. [R. 36, 41-43.]

Statement of Points to Be Urged.

The points to be urged are set forth in detail in the "Appellant's Statement of Points to be Relied upon on Appeal." [R. 162-165.] In essence, the Government asserts that the court below erred in entering the conclusion of law that the amount realized by the taxpayer in the compromise settlement of her claim to be an heir to the estate of Flood did not constitute taxable income to her.

Summary of Argument.

In order to claim an exemption from taxable income for the amount realized on the taxpayer's settlement of her claim to be an heir to the estate of Flood as property acquired by "bequest, devise, or inheritance" under the provisions of Section 22(b)(3) of the Revenue Act of 1934, the taxpayer must have proved that she received such amount as an heir and that such amount was paid to her from the estate of Flood.

The court below erred in granting the exemption (a) because there is no finding that she was an heir and received the amount in question as such; (b) because the probate court administering Flood's estate found as a fact that she was not an heir; and (c) because the amount she realized was not acquired from the decedent through his estate, but was acquired by contract between the taxpayer and certain beneficiaries of the estate under which she received approximately one-half of that amount from their own private funds and the balance from an assignment of a part of their share in the estate.

ARGUMENT.

The Amount Realized by the Taxpayer by Settlement of Her Claim to Be an Heir Was Not Acquired by "Inheritance."

Section 22(b)(3) of the Revenue Act of 1934 [Appendix, *infra*], which enumerates the "exclusions from gross income", provides, *inter alia,* that "the value of property acquired by gift, bequest, devise, or inheritance" "shall not be included in gross income and shall be exempt from taxation under this title."

The taxpayer contends, and the court below held, that the $206,974.43 which she realized under the settlement agreement came within this exemption. This exemption is to be strictly construed and the taxpayer claiming its benefits has the burden of proving that she clearly comes within its terms. *Parrott v. Commissioner,* 30 F. (2d) 792 (C. C. A. 9th); *Riverdale Co-op. Creamery Ass'n v. Commissioner,* 48 F. (2d) 711 (C. C. A. 9th).

The taxpayer has not asserted that her acquisition was by "gift", "bequest", or "devise." Necessarily, it must be asserted that the property was acquired by "inheritance" within the meaning of Section 22(b)(3) of the Revenue Act of 1934.

The term "inheritance" in this exemption was interpreted in *Lyeth v. Hoey,* 305 U. S. 188, 194-195, as follows:

> *Second.* In exempting from the income tax the value of property acquired by "bequest, devise, or inheritance," Congress used comprehensive terms embracing all acquisitions in the devolution of a decedent's estate. For the word "descent," as used in the earlier acts, Congress substituted the word "inheritance" in the 1926 Act and the subsequent revenue

> acts as "more appropriately including both real and personal property." Thus the acquisition by succession to a decedent's estate whether real or personal was embraced in the exemption. Further, by the "estate tax," Congress has imposed a tax upon the transfer of the entire net estate of every person dying after September 8, 1916, allowing such exemptions as it sees fit in arriving at the net estate. Congress has not indicated any intention to tax again the value of the property which legatees, devisees or heirs receive from the decedent's estate.

In order to be entitled to the exemption claimed, the taxpayer must have proved that the amount she realized was a transfer from the decedent by reason of his death and that the amount realized was paid to her as an heir.

The Government maintains that the judgment of the court below cannot be sustained because, first, there is no finding that the amount the taxpayer received as a result of the compromise of her claim to be an heir was paid to her as an heir; secondly, the findings and undisputed facts establish that the amount she received was not paid to her as an heir; and thirdly, the amount realized did not come from the decedent's estate.

A. The Consideration Given to the Taxpayer Under the Settlement Agreement Was Not Paid to Her as an Heir.

The taxpayer is not entitled to the claimed exemption because the amount realized under the settlement agreement was not paid to her as an heir, but in compromise of *her claim to be an heir* of Flood's estate.

Reduced to its essentials, the taxpayer entered into an agreement under which she received certain property and

money for renouncing *her claim to be an heir* and her share of the estate *if* she was an heir.[1] As such the amount realized was the fruit of a private contract and was not received by intestate succession. The importance of this distinction is evident in the leading case on this question, *Lyeth v. Hoey, supra,* cited by the court below and relied on so strongly by the taxpayer. In that case Lyeth, the taxpayer, was an heir and legatee of a deceased grandmother. When her will was offered for probate, the heirs objected to the probate of the will on the ground of the lack of testamentary capacity, among other grounds. An agreement was entered into between the heirs, legatees, devisees, executors and the Attorney General of Massachusetts, whereby the taxpayer, together with the other heirs, in compromise of their claim, received a portion of the residuary estate. The Supreme Court held that the amount received by Lyeth under that settlement agreement was exempt from income tax as property acquired by "bequest, devise, or inheritance" within Section 22(b)(3) of the Revenue Act of 1932, which is the counterpart of the exemption involved in this case. The Court made these pertinent observations (pp. 195-197):

> *Petitioner was concededly an heir* of his grandmother under the Massachusetts statute. *It was by virtue of that heirship* that he opposed probate of her alleged will which constituted an obstacle to the enforcement of his right. *Save as heir he had no standing.* Seeking to remove that obstacle, he asserted that the will was invalid because of want of testamentary

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[1]There can be little doubt that the settlement agreement between the taxpayer and the beneficiaries of the estate was a valid contract. See *Wilson v. Davis,* 11 Cal. (2d) 761, 81 P. (2d) 971; *Bacon v. Kessel,* 31 Cal. App. (2d) 245, 87 P. (2d) 857. See also *Estate of Rossi,* 169 Cal. 148, 146 Pac. 430.

capacity and undue influence. * * * It was in that situation, facing a trial of the issue of the validity of the will, that the compromise was made by which *the heirs, including the petitioner,* were to receive certain portions of the decedent's estate.

There is no question that petitioner obtained that portion, upon the value of which he is sought to be taxed, *because of his standing as an heir and of his claim in that capacity.* It does not seem to be questioned that if the contest had been fought to a finish and petitioner had succeeded, the property which he would have received would have been exempt under the federal act. Nor is it questioned that if in any appropriate proceeding, instituted by him as heir, he had recovered judgment for a part of the estate, that part would have been acquired by inheritance within the meaning of the act. We think that the distinction sought to be made between acquisition through such a judgment and acquisition by a compromise agreement in lieu of such a judgment is too formal to be sound, as it disregards the substance of the statutory exemption. *It does so, because it disregards the heirship which underlay the compromise, the status which commanded that agreement and was recognized by it.* * * * That portion he obtained because of his heirship and to that extent he took in spite of the will and as in case of intestacy. * * *

We are not convinced by the argument that petitioner had but "the expectations" of an heir and realized on a "bargaining position". *He was heir in fact.* Whether he would receive any property in that capacity depended upon the validity of his ancestor's will and the extent to which it would dispose of his ancestor's estate. When, by compromise and the decree enforcing it, that disposition was limited, *what*

> *he got from the estate came to him because he was heir,* the compromise serving to remove *pro tanto* the impediment to his inheritance. We are of the opinion that the exemption applies. (Italics original.)

The salient fact, repeatedly emphasized in the opinion in *Lyeth v. Hoey, supra,* as indicated by the portion quoted, is that the taxpayer there involved entered into a compromise agreement in the undisputed status of an heir. See *Helvering v. Safe Deposit Co.,* 316 U. S. 56. That fact is not present here. The taxpayer in this case has not been established as an heir; that was the issue of fact which was so vigorously disputed by the established heirs [R. 89]; that was the issue resolved against the taxpayer on the first trial by the probate court on a directed verdict [R. 34]; that was the issue which the taxpayer conceded in the settlement agreement [R. 86-94]; that was the issue determined against the taxpayer by the probate court on the second trial, if only by reason of the settlement agreement [R. 98].

The Government is not urging any formal distinction between the amount claimed by an heir through intestacy and the amount received by an heir by compromise, as in *Lyeth v. Hoey, supra.* The Government is asserting the distinction between the amount received by an heir and one who claims to be an heir but never establishes her status as such. Obviously, if the taxpayer had judicially established her claim to be an heir, her distributive share would constitute an "inheritance." Instead, she chose to forego her claim to be an heir and her chances of a favorable decision, which had speculative value only, for the payment of $206,974.43.

The court below was under the erroneous impression that the Government was endeavoring to go back of the

compromise to try the issue of heirship. On the contrary, the compromise is being relied on. Any such issue would necessarily have to be raised by the taxpayer. It was her burden to prove that she was an heir and that the amount she received in compromise was paid to her in that status. No such finding was made by the court below. The only finding made on this issue was the finding of the probate court that she was not the daughter of Flood. [R. 98, 100.] While this finding may have been made as a result of the settlement, it is just as conclusive between the parties as one entered upon contest and trial. *Moore v. Schneider,* 196 Cal. 380, 389, 238 Pac. 81; *Nielsen v. Emerson,* 119 Cal. App. 214, 218, 6 P. (2d) 281.

In any event, the evidence establishes that the amount realized by the taxpayer was not paid to her exclusively as partial compensation for her claimed share of the estate. While the parties stipulated, and the court below found, that the settlement was between the taxpayer and "representatives of said estate" [R. 34], the parties to the written agreement were the taxpayer, Flood's widow as a trustee of a trust created by his will,[2] Flood's daughter and Flood's son. In addition to the reduction of the amount of the taxpayer's claim, the agreement made detailed and elaborate provisions whereby the taxpayer renounced not only her property claims against the estate, but stipulated that she was not the daughter of Flood and that she would never thereafter claim to be his daughter. These concessions were undoubtedly a material part of the consideration for which Flood's wife and children were willing to pay and did pay under the agreement. *Cf. Smithsonian Institution v. Meech,* 169 U. S. 398, 415. The portion of

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[2]While Flood's widow was also executrix of his will, she was not designated as such in the settlement agreement.

the consideration received by the taxpayer for these concessions is distinct from any other portion attributable to intestate succession. *Cf. Alphonzo E. Bell Corp. v. Commissioner,* 145 F. (2d) 157 (C. C. A. 9th).

The court below was apparently of the opinion that a decision in favor of the Government would discourage the compromise of claims against estates such as the taxpayer's herein. That possibility or probability cannot determine whether income tax liability exists.

The distinguishing facts of *Lyeth v. Hoey, supra,* are also present in other decisions heretofore cited by the taxpayer and relied on by the court below. For example, in *Magruder v. Segebade,* 94 F. (2d) 177 (C. C. A. 4th), the taxpayers there involved, who were legatees under one will, entered into a compromise agreement with the legatees of a subsequent will, under which the taxpayers received a portion of the latter's distributive share under the second will in consideration of the taxpayer's not contesting that will. The court ruled that the amount realized under this agreement was not taxable income. It is to be noted that the taxpayers in that case made their claim and entered into the settlement in the undisputed status of legatees of an earlier will. The same distinction is present in *Keller v. Commissioner,* 41 B. T. A. 478; *Rhodes v. Commissioner,* decided September 16, 1944 (1944 P-H T. C. Memorandum Decisions, par. 44,301); *Goldman v. Commissioner,* decided July 28, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,360).

The decision in *Estate of Howard v. Commissioner,* decided December 9, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,503), is authority for the Government's position herein, rather than the taxpayer's. The estate there involved settled the judgment upholding the claim in

favor of a person claiming to be the illegitimate child and pretermitted heir, pending the estate's appeal from that judgment. The Tax Court disallowed the claim for a deduction of the amount paid in settlement as an administration expense in computing the estate tax, pointing out the fact that there had been a verdict entered that the claimant against the estate was the daughter of the decedent (which is contrary to the facts herein), and that the amount paid to her was a "distribution from the estate" and not the payment of "costs or expenses." In any event, the question there involved was the interpretation of a statutory deduction in computing estate tax, and not the exemption from income tax involved herein. See *Robbins v. Commissioner,* 111 F. (2d) 828 (C. C. A. 1st). Also, the settlement there involved was made directly with the executors, a distinction elaborated in the discussion following.

B. The Amount Realized by the Taxpayer Under the Settlement Agreement Did Not Come From the Estate.

It is plain, under *Lyeth v. Hoey, supra,* that in order to be entitled to the claimed exemption it must be shown that the amount alleged to have been acquired by "inheritance" must have in fact come from the decedent through his estate.

The second basic reason why the taxpayer is not entitled to the claimed exemption is that the amount she realized did not come from the decedent through his estate. This is established in fact and in law to the extent of $100,000, at least, of the total amount realized by the taxpayer. The settlement agreement expressly provided [R. 92]:

> In addition to the foregoing, said Maud Lee Flood, Mary Emma Flood Stebbins, and James Flood are to pay to said first party [the taxpayer] and/or her as-

> signs, the sum of $100,000. *out of their own funds and not distributable out of the estate of said deceased,* and are to make and agreement contemporaneously with the delivery by the first party of this agreement in respect of property belonging to the said estate not now known or discovered but which may later become known or discovered. (Italics original.)

It is submitted that the $100,000 realized by the taxpayer under this portion of the agreement was not acquired by "inheritance" and is taxable as income to her.

The Government maintains that the balance of the amount realized by the taxpayer also was not derived from the estate, but from the property of the beneficiaries of the estate. The written settlement agreement is not between the taxpayer and the executrix of the estate. The agreement was made between the taxpayer and the trustee and two of the beneficiaries of a trust created by the decedent's will. As such we maintain that the taxpayer's agreement was a contract between persons who were legatees and beneficiaries of the estate whereby, for valuable consideration, they assigned a portion of *their* inheritance to the taxpayer. This is not a conclusion, but the express agreement of the parties stated in the following language [R. 90]:

> Nevertheless the second parties do not desire to carry on the litigation and have arranged a compromise thereof with the first party [the taxpayer] whereunder the second parties will *transfer, assign and set* over to the said first party and her transferees and assigns certain interests *to which the second par-*

> *ties are entitled under the will of said deceased* as follows: (Italics original)

after which there were listed certain stocks consisting of part or all of the corpus of the above-mentioned trust, certain other securities, certain realty owned by the decedent and [R. 91]—

> An undivided 4/27ths of any unexpended balance *which may be received by them* from the estate, after all charges and expenses have been paid, which 4/27ths is estimated to amount to between $5,000. and $7,500. (Italics original.)

In addition, the taxpayer was to receive $20,000 out of the legacies to two religious and five charitable institutions which were abated to that extent.

It is evident that the settlement constituted a private agreement between certain of the beneficiaries of the estate and the taxpayer, whereby the beneficiaries delivered to the taxpayer certain moneys out of their own funds, and assigned a portion of their share of the estate which was distributable to them. As such it is clearly the fruit of a private contract not realized by descent and distribution from the estate. It is to be noted that the amounts paid to the taxpayer were not made out of the legacies in the will under the provisions of Section 91 of the Probate Code of California [Appendix, *infra*], which controls the source of payment of the distributive share of a pretermitted heir, but by private contract.

The fact that the probate court took cognizance of the settlement and, so far as it was able, carried it out does not detract from the fact that the estate was not a party to the agreement and the fact that the probate court was simply recognizing an assignment of a portion of the estate.

The final decree of distribution expressly recognized this to be true as is evident from the following language [R. 113-114]:

> Said Maud Lee Flood, as such trustee, consents to the distribution of 5896 shares of the capital stock of the Flood Realty Company which would otherwise be distributable to her as trustee, to the persons and in the number of shares below named, *and requests the court to make distribution accordingly:*
>
> | | |
> |---|---|
> | To Constance May Gavin | 2,948 shares Flood Realty Company |
> | To Carmelita Aureguy | 1,474 shares Flood Realty Company |
> | To Maxwell McNutt | 700 shares Flood Realty Company |
> | To John J. Taa*fe,* and Tressie G. Taaffe, his wife, as Joint Tenants | 700 shares Flood Realty Company |
> | To Albert Mansfield | 74 shares Flood Realty Company |
> | | 5,896 |
>
> Maud Lee Flood, individually, Mary Emma Flood Stebbins and James Flood, hereby consent to distribution out of property to which they would be otherwise entitled, *and request the Court to make distribution as follows:*
>
> * * * * * * * *
>
> (Italics original.)

Conclusion.

The Government respectfully submits that the sum of $206,974.43 realized by the taxpayer under the settlement agreement in question was not acquired by "gift, bequest, devise, or inheritance" within the meaning of Section 22 (b)(3) of the Revenue Act of 1934, and is therefore taxable as income to her. Hence, the decision of the court below should be reversed.

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May, 1946.

APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * * * * *

(3) *Gifts, Bequests, and Devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or

exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * * * * *

Probate Code of California (1931), Div. I, c. IV:

§90. *Rights of children and grandchildren.* When a testator omits to provide in his will for any of his children, or for the issue of any deceased child, whether born before or after the making of the will or before or after the death of the testator, and such child or issue are unprovided for by any settlement,

and have not had an equal proportion of the testator's property bestowed on them by way of advancement, unless it appears from the will that such omission was intentional, such child or such issue succeeds to the same share in the estate of the testator as if he had died intestate.

§91. *Sources of unmentioned child's share.* The share of the estate which is assigned to a child or issue omitted in a will, as hereinbefore mentioned, must first be taken from the estate not disposed of by the will, if any; if that is not sufficient, so much as may be necessary must be taken from all the devisees or legatees, in proportion to the value they may respectively receive under the will, unless the obvious intention of the testator in relation to some specific devise or bequest, or other provision in the will, would thereby be defeated; in such case, such specific devise, legacy or provision may be exempted from such apportionment, and a different apportionment, consistent with the intention of the testator, may be adopted.